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In the Supreme Court of the United States

OCTOBER TERM, 1962

No. 96

UNITED STATES, PETITIONER

v.

BUFFALO SAVINGS BANK

ON WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE STATE OF NEW YORK

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The first opinion of the Erie County Court (R. 37–42), is reported at 186 N.Y.S. 2d 960, 17 Misc. 2d 564. The opinion of the Appellate Division (R. 19–22), is reported at 202 N.Y.S. 2d 70, 11 App. Div. 2d 158. The opinion of the Erie County Court on remand (R. 12–19), is reported at 206 N.Y.S. 2d 518, 26 Misc. 2d 443. The opinion of the Appellate Division on the second appeal (R. 64–68) is reported at 215 N.Y.S. 2d 189, 13 App. Div. 2d 207. The opinion of the New York Court of Appeals (R. 74–91), is reported at 11 N.Y. 2d 31, 226 N.Y.S. 2d 382.

JURISDICTION

The judgment of the Court of Appeals of the State of New York was entered on February 22, 1962 (R. 91–92). The petition for a writ of certiorari was filed on April 30, 1962, and was granted on June 11, 1962 (R. 93; 370 U.S. 915). The jurisdiction of this Court rests on 28 U.S.C. 1257(3).

QUESTION PRESENTED

Whether the priority of payment accorded an earlier-arising federal tax lien by *United States* v. *New Britain*, 347 U.S. 81, may be defeated by a provision of State law that payments to discharge local tax liens shall be "deemed" expenses of a mortgage foreclosure sale.

STATUTES INVOLVED

The pertinent provisions of the Internal Revenue Code of 1939, the statutes of the State of New York, the Tax Act of Erie County, and the City of Buffalo Charter, are set forth in the appendix, *infra*, pp. 33–37.

STATEMENT

This is a mortgage foreclosure case which involves the relative priority of a federal tax lien and local (city and county) liens on the proceeds of the foreclosure sale of the property to which the liens had attached.

On April 5, 1946, respondent Buffalo Savings Bank (the mortgagee-bank) lent $2,600 to Joseph B. Victory (the taxpayer-mortgagor), receiving a mortgage on real property to secure its loan. The mortgage was recorded on the same day (R. 31–32, 74). On January 15, 1953, the United States filed in the Erie County

Clerk's office a notice of a federal tax lien for $857.07, against the mortgagor (R. 36, 50, 74).[1] On and after July 1, 1957, local liens attached to the mortgaged property resulting from defaults in the payment of real estate taxes for 1957 and 1958 owed to the City of Buffalo, real estate taxes for 1958 owed to Erie County, and sewer rents levied by the Buffalo Sewer Authority (R. 34, 74).[2]

The present action for foreclosure of its mortgage was begun in the Erie County Court on October 21, 1958, by the bank (R. 42, 49). At that time, there was a balance due on the mortgage of $1,473.75, plus interest at the rate of 5 percent per annum, from January 10, 1958 (R. 35). The record does not show the amounts due on account of the local taxes and assessments. Nor does it indicate that the mortgagor was insolvent (R. 86).

The Erie County Court entered a judgment, pursuant to the mortgagee-bank's motion for summary judgment, providing that the mortgaged property should be sold "subject to all taxes, assessments and water rates, which are or may become liens on the premises at the time of the sale," but free and clear of the federal tax lien, and that after payment of the expenses of the foreclosure, the proceeds be used first to satisfy the mortgage debt (R. 29, 36–38).[3] Upon

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[1] Of this amount, a balance of $689.07, plus interest, remained unpaid on January 5, 1959, when the United States filed an answer to the complaint herein (R. 50–51).

[2] The mortgagee-bank did not advance any sums for payment of these local real property taxes and assessments (R. 36, 74).

[3] The County Court's opinion (R. 37–42), entered May 29, 1959, is reported at 186 N.Y.S. 2d 960, 17 Misc. 2d 564.

appeal by the United States, the Appellate Division reversed the judgment,[4] stating (R. 20) that a sale free and clear of the federal tax lien but subject to local liens would erroneously give the local liens "a super-priority," in disregard of the fact that they are inferior to the earlier-arising federal tax lien. The court suggested that the local taxing authorities be made parties to the action and that the property be sold free and clear of all liens, leaving the question of priorities to be decided at a later date (R. 22).

Upon remand, the County Court amended its judgment to order a sale free of all liens, the proceeds of which were to be used first to pay all local real estate taxes, assessments and water rates "as a part of the expenses of the sale," pursuant to Section 1087 of the New York Civil Practice Act (R. 3–5).[5] The Appellate Division modified the judgment (R. 60–64) to apply to the proceeds of the foreclosure sale "the rule of priorities laid down in *United States* v. *City of New Britain*, 347 U.S. 81" (R. 65) under which the liens for local taxes, assessments and water rates are "inferior to the tax lien of the United States, having accrued subsequent to the time of the filing of the United States tax lien" (R. 67, R. 68–73).[6]

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[4] Its *per curiam* opinion (R. 19–22) is reported at 202 N.Y.S. 2d 70, 11 App. Div. 2d 158.

[5] Its opinion (R. 12–19), dated October 18, 1960, is reported at 206 N.Y.S. 2d 518, 26 Misc. 2d 443.

[6] The court's opinion (R. 64–68) is reported at 215 N.Y.S. 2d 189, 13 App. Div. 2d 207.

"The Appellate Division directed that the property be sold free and clear of all liens; that the proceeds be deposited in a bank; that from such proceeds the referee pay the fees, costs

On appeal by respondent, a majority of the New York Court of Appeals (R. 74–83), although approving the order directing a sale of the property free and clear of all liens, reversed the Appellate Division's decision as to the distribution of the proceeds and reinstated the County Court judgment of foreclosure which authorized the payment of later-arising local taxes ahead of prior federal taxes, as expenses of the foreclosure sale (R. 3–5, 26, 36). Judge Fuld (with whom Judge Foster concurred), dissenting (R. 83–90), stated (R. 89) that "[i]t comports neither with reality nor with law to give such 'potential liens priority over the pre-existing matured Federal lien by labeling them 'expenses of the sale' in foreclosure proceedings."

SUMMARY OF ARGUMENT

In *United States* v. *New Britain*, 347 U.S. 81, this Court announced three controlling principles with respect to federal lien law applicable under Sections 3670–3672 of the Internal Revenue Code of 1939: (1) that a local real estate tax lien cannot compete with a federal tax lien until it becomes choate by attachment to specific pieces of real property; (2) that as be-

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and disbursements allowed; that out of the net proceeds then remaining, the referee set aside, in a separate bank account in his name, designated as 'Priority Adjustment Fund,' the sum due upon the mortgage and also a sum sufficient to pay other outstanding liens, if any, superior to the tax lien of the United States; that from the balance, if any, remaining, the referee pay first the tax lien of the United States, and then the local real estate taxes, assessments and water rates; that if there were insufficient moneys available to pay such real estate taxes, assessments and water rates, the balance thereof was to be paid out of the Priority Adjustment Fund" (R. 61–62).

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tween the federal tax lien and choate or perfected local real estate tax liens, absent insolvency, priority is determined by the rule of first in time, first in right, so that a federal tax lien is superior to a later-arising local real estate tax lien; and (3) that the priority of a federal tax lien under federal law cannot be impaired or affected by state rules of priority which accord local real estate tax liens priority over any mortgage. *New Britain* has thus provided the basic rule of decision with respect to the definition of choate liens, the priority of liens and the supremacy of the federal lien law. The decision has been steadily followed, not only in the general field of federal tax lien law, but also by three courts of appeals and two State Supreme Courts in the specific situation—present here—of a foreclosure of a senior mortgage which under state law is subordinated to local real estate tax liens.

Although the facts of the instant case are "on all fours" with those of *United States* v. *New Britain*, the New York Court of Appeals (two judges dissenting) has failed to follow that decision. It has held that local real estate taxes which accrued subsequent to the filing of notice of a federal tax lien are entitled to payment ahead of the federal tax lien out of the proceeds of sale of the mortgaged property as a part of the "expenses of the sale," as provided by Section 1087 of the New York Civil Practice Act. The ruling accords such taxes a "super-priority" directly contrary to every principle of *New Britain*.

The correctness of *New Britain* and the error of the majority decision below are demonstrated by the

fallacious propositions upon which the latter must rely. The prime fallacy is the assertion that the lien for local real estate taxes is by nature paramount to the federal tax lien, so that the *New Britain* rule of first in time, first in right, is rendered wholly inapplicable. In an effort to gain support from the principle of *Aquilino* v. *United States,* 363 U.S. 509, that state law defines the property rights subject to the federal tax lien, the majority attempts to cloak this assertion as a statement of the rights of a taxpayer in real property under New York law. The theory is that an owner's interests are conditioned upon the payment of local taxes, and the United States as a creditor of the taxpayer is subject to the same overriding limitation. It is manifest, however, even from the majority opinion itself that this supposed limitation on the taxpayer's interest does not stem from any lack of ownership rights, but rather is derived from the assertedly superior nature of the State tax lien. The majority recognizes that the taxpayer possesses a fee. Its position is that the State tax liens attach directly to this property while the federal tax lien attaches only to the taxpayer's interest in the property. But this distinction is directly contrary to the settled decisions of this Court. The law established by this Court holds that the federal tax lien attaches to the property itself, exactly as a state tax lien (*e.g., Michigan* v. *United States,* 317 U.S. 338) and takes priority over all subsequently attaching liens.

In any event, a state court may not confine the federal tax lien to special property rights determined only for purposes of the federal tax lien. For all other purposes New York property law treats a tax-

payer as the owner of the property as against both the mortgagee and the State, neither of which has more than a lien interest in the property. The federal tax lien therefore attached to the general ownership rights of the taxpayer, and once attached, could not be displaced by subsequent local tax liens.

Once the basic propositions involved in this case are stated, the remaining issues are speedily resolved. The State cannot impair the federal statutory lien by deeming subsequently-accrued local tax liens "expenses of the foreclosure sale." Such state provisions to assure the payment of state taxes cannot convert them into prior liens as against the earlier-assessed and perfected federal tax liens. Nor is there anything in *United States* v. *Brosnan*, 363 U.S. 237, which qualifies the priority of federal tax liens over later-arising state tax liens. On the contrary, in holding that state procedures for the extinguishing of liens junior to a mortgage were applicable to junior federal tax liens, this Court expressly reaffirmed the order of priority in time established by *New Britain*.

Faced with the problem of circular priorities which *New Britain* resolved by maintaining the underlying priority of the federal tax lien, the majority below has here resolved the problem by eliminating it. In its view, there is no circular priority, because the federal tax lien has no competing priority at all; it is always subordinate to an earlier mortgage and to later state taxes. But this resolution subverts basic principles of federal tax lien law.

The *New Britain* decision has been consistently followed by other courts, which have rejected the dis-

tinctions attempted by the court below. The priority of the federal tax lien was established by this Court on the ground that Congress, in order to protect federal revenues, provided for such a lien. There is no showing here that the federal lien so established has overburdened either municipalities or mortgagees. By contrast, the decision below would impose upon the federal government the impossible burden of seeking immediate foreclosure of its tax liens in order to protect itself against later-arising local real estate taxes.

ARGUMENT

FEDERAL LAW GIVES THE FEDERAL TAX LIEN PRIORITY OVER SUBSEQUENTLY ACCRUED LIENS FOR CITY AND COUNTY TAXES AND STATE LAW CANNOT REVERSE THE ORDER OF PAYMENT BY "DEEMING" THE LOCAL LIENS "EXPENSES OF THE [FORECLOSURE] SALE"

In *United States* v. *New Britain*, 347 U.S. 81, this Court struck down a State's direct attempt by statute to grant local real estate tax liens priority over "all other liens or encumbrances" (*id.* at 83) including previously filed federal tax liens. The Court held that "the State cannot on behalf of the City impair the standing of the federal liens, without the consent of Congress" (*id.* at 84) and that Congress, when it enacted Section 3670 of the Internal Revenue Code of 1939 (which created the federal tax lien), had incorporated therein as a federal rule of priority the principle of law that "the first in time is the first in right" (*id.* at 85–86). The question in this case is whether a State may achieve by indirection what it may not do directly, that is, may a State afford sub-

sequently-accruing local tax liens first priority by means of a statute which directs that such liens shall be "deemed" expenses of the foreclosure sale and paid out of the proceeds in advance of all other liens. We think it clear that the *New Britain* decision cannot be so easily defeated.

A. THE *NEW BRITAIN* CASE IS CONTROLLING AND REQUIRES THAT THE FEDERAL TAX LIEN BE GIVEN PRIORITY OVER THE SUBSEQUENTLY ACCRUED LOCAL TAX LIENS

The relevant facts of the *New Britain* case were these: A foreclosure sale of the taxpayer's real property produced a fund of $28,071 against which were claims of $31,000 including the expenses of the sale, two mortgages, a recorded judgment, city real-estate-tax liens and water-rent liens, and federal tax liens. The state courts held that the city liens were entitled to payment prior to all other claims except those for expenses of sale, regardless of the date on which they became perfected and attached to the taxpayer's property. This Court reversed and held, in an opinion which has furnished the foundation for a long line of later decisions,[7] that, although Congress did not set forth a schedule of priorities in Section 3670, it implicitly incorporated the familiar rule of "first in time, first in right" (*id.* at 87), which makes the

[7] *United States* v. *Acri*, 348 U.S. 211; *United States* v. *Liverpool & London Ins. Co.*, 348 U.S. 215; *United States* v. *Scovil*, 348 U.S. 218; *United States* v. *Colotta*, 350 U.S. 808; *United States* v. *White Bear Brewing Co.*, 350 U.S. 1010; *United States* v. *Vorreiter*, 355 U.S. 15; *United States* v. *Ball Construction Co.*, 355 U.S. 587; *United States* v. *Hulley*, 358 U.S. 66. See also *Crest Finance Co.* v. *United States*, 368 U.S. 347, and *United States* v. *Brosnan*, 363 U.S. 237, 240.

priorities of competing local real estate and federal tax liens "depend on the time [each] attached to the property in question and became choate" (*id.* at 86). The local assessed real estate tax lien did not become choate until it attached to specific property, at which point it received equal status with the federal tax lien arising upon assessment. Accordingly, the Court held, any federal tax liens which attached to the taxpayer's property at an earlier date than the local liens for real estate taxes and water rents were entitled to a prior right to the proceeds of sale of the property.

The Court specifically rejected the contention that Congress did not intend the rule of "first in time, first in right" to supersede state laws of priority at least to the extent that they made certain interests superior to mortgages. It made no difference, the Court said, that because of state laws payment of the federal tax lien might come at the expense of the mortgagee whose lien was recorded first and was therefore first in priority under federal law. This "circular priority" could not change the Court's finding that Congress intended to adopt a single rule for determining the priority of federal tax liens. Thus, it declared (*id.* at 88):

> * * * The United States is not interested in whether the State receives its taxes and water rents prior to mortgagees and judgment creditors. That is a matter of state law. But as to any funds in excess of the amount necessary to pay the mortgage * * * Congress intended to assert the federal lien. * * *

Since the significant facts in the present case are indistinguishable from those in *New Britain*, that decision requires the federal lien to be given priority over the subsequent state liens. Here the federal lien was perfected on January 15, 1953, when the notice of lien was filed in the County Clerk's Office (see *supra*, pp. 2–3). The state liens did not come into existence until more than four years later (in 1957 and 1958) (*ibid.*). The federal lien was thus unquestionably the "first in time," and under *New Britain* it was therefore the "first in right."

The New York Court of Appeals, refusing to follow *New Britain*, held (R. 74) that "the Federal tax lien is not entitled to priority over subsequently accrued local tax liens—superior to the mortgage debt—since the respective liens are not comparable charges on real property and the 'mortgagee' has an absolute preference over Federal liens."

This conclusion involves the rejection of the findings and principles on which *New Britain* stands. It discards the rule of "'first in time, first in right,'" and, by treating the liens for local taxes as if they attached on the date of the mortgage, adopts a position analogous to the doctrine of relation-back to defeat the priority of the federal tax lien. This reasoning is contrary to the rule of *United States* v. *Security Tr. & Sav. Bk.*, 340 U.S. 47, 50, and numerous subsequent decisions of this Court that the doctrine of relation back cannot "operate to destroy the realities of the situation."* The decision below rejects the choate or perfected lien test which has been applied by this Court in cases of this kind, without exception, and it rejects the su-

* See *United States* v. *Ball Construction Co.*, 355 U.S. 587.

premacy of federal law which this Court has held to be controlling in matters involving the relative priority of federal liens (*Aquilino v. United States*, 363 U.S. 509, 513–514).* Finally, and in direct conflict with the square holding in *New Britain* (347 U.S. at 88), the majority finds that Congress, in creating the federal tax lien and establishing its priority, did not intend to "curtail the absolute preference granted to mortgagees" (R. 77). In support or explanation of these conflicts, the majority attempts to distinguish *New Britain*, but, as stated by Judges Fuld and Foster in dissent (R. 83–90) and as will be shown below, none of the distinctions is tenable. In sum, the decision of the majority would negate the large body of federal lien law already established by this Court.

B. THE GROUNDS ON WHICH THE COURT BELOW ATTEMPTED TO DISTINGUISH AND LIMIT *NEW BRITAIN* ARE UNTENABLE

1. The liens competing here are of equal dignity and the federal lien takes priority over the later local tax liens

The local tax liens involved in *New Britain* were exactly the same as those involved in this case, namely, municipal liens for real property taxes and water rates owed by the taxpayer mortgagor. The foundation of the *New Britain* ruling is the Court's holding (347 U.S. at 84) that—

> the general statutory liens of the United States are as binding as the specific statutory liens of the City. The City gains no priority by the

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*The decision below is severely criticized on these and other grounds by Professor Charles Seligson in "*Creditors' Rights*," *1961 Annual Survey of American Law*, 273, 278–279, 281.

> fact that its liens are specific while the United States' liens are general. Obviously, the State cannot on behalf of the City impair the standing of the federal liens, without the consent of Congress. * * *

The majority below attempted to distinguish *New Britain* upon the ground that the liens are not comparable. Thus, the majority says (R. 78) that the claim of the United States—

> depends on the obviously fallacious contention that the lien of the municipality upon the land is akin to the lien of the Federal Government as a creditor of the mortgagor. The plain answer is that the Federal Government is only the creditor of a debtor whose interest in the land is subordinate to the local government lien * * *. As a lien for taxes for essential services supplied for the benefit of the land, it attached directly to the particular parcel of real property. The Federal lien was filed in the Clerk's office against a presumed equity in the real property held by the mortgagor. * * *

This ruling that the two liens are not akin and that the local liens are by nature superior because they attach to the specific property is the core of the majority's position. However, in comparing the two liens and holding them disparate, the majority, despite its disclaimer, has necessarily determined the nature of the federal tax lien. This, however, is a matter of federal, not state, law. Moreover, the majority's determination of the nature of the federal tax lien is directly contrary to the holdings of this Court that, as a matter of federal law, the federal tax lien attaches

to the same property to which the state-created liens attach. *Michigan* v. *United States*, 317 U.S. 338; *United States* v. *New Britain*, *supra*, and cases cited, note 7, *supra*.

Recognizing the force of these holdings, the majority has expressly disclaimed any attempt to pass upon the nature of the federal tax lien. Thus, it stated (R. 76):

> Our State law has not characterized the nature and extent of the Federal tax lien, but has determined the nature and extent of the property interests of the taxpayer (admittedly a State function), which in the case of real property is conditioned upon the payment of annually recurring governmental land taxes, the payment of which may not be avoided by a foreclosure sale; * * *

The court is attempting to rely on *Aquilino* v. *United States*, *supra*, where this Court held that federal and state courts are to look to state law to determine the property rights to which the federal tax lien attaches. This reliance is misplaced.

The court is not here giving effect to a state definition of property interests. It is clear from the court's statement—"the property interests of the taxpayer * * * in the case of real property is conditioned upon the payment of annually recurring governmental land taxes"—that under New York law the taxpayer does own a fee even though his interest may be diminished for failure to pay subsequently accruing local taxes.[10]

[10] In this connection it is noted that the New York statutes merely impose liens upon the property for the non-payment of real estate taxes and water rents. They do not purport to define or limit the owner's interest. See Appendix, *infra*, pp. 35–36.

Thus, the majority is not giving effect to a state definition of property which precludes attachment of the federal lien, but is merely asserting the paramount nature of the local tax lien under local law. Since the taxpayer owns the fee, then under *Aquilino* the federal tax lien attaches to that fee and enjoys priority over all later accruing liens."

For all purposes other than determining the relative priority of the federal tax lien and local liens, the State of New York treats the mortgagor as the owner of the property, and not merely as the holder of whatever equity may remain after prior claims against the property have been satisfied. The New York law of real property, like that of Connecticut, is that a mortgage is merely security for a debt, and gives the mortgagee no title or estate whatever. Both in law and equity, the mortgagor is regarded as the owner of the fee. His interest in the real estate can be sold upon execution; his widow is entitled to dower; he can convey and devise his interest as real estate; at his death, it descends to his heirs; he has every attribute and right of an absolute owner of the real estate, subject to the lien of the mortgage, and his title can be de-

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"It is a misapplication of *New Britain* and *Michigan* to hold, as the majority below does, that the federal tax lien is subordinate to the lien of subsequently accruing city taxes, because the interests of a mortgagor-taxpayer are subordinate thereto. As Judge Parker stated in *United States* v. *City of Greenville*, 118 F. 2d 963, 966 (C.A. 4), (cited with approval in *Michigan*):

"The difference is that the rights of the mortgagee as well as of the mortgagor in the mortgaged property are held subject to the power of the state to tax it, whereas the rights of the federal government are not held subject to that power."

feated only by foreclosure; he remains the true owner and may maintain trespass even against the mortgagee. While in relation to the mortgagee, his estate is usually called an equity of redemption, "as to all the world he is the owner." *Trimm* v. *Marsh*, 54 N.Y. 599, 603–604, 608.

This ownership interest was the property which the taxpayer held on the date the federal tax was assessed, and on the date (January 15, 1953) when notice of that lien was filed. The fact that the taxpayer-mortgagor's interest in the property was subject to being terminated under a state mortgage-foreclosure proceeding neither limited his interest nor diminished the "property" to which the federal lien attached, for "the mortgagors owned the entire fee interests in the properties, subject only to the mortgages." *United States* v. *Brosnan*, 363 U.S. 237, 241. As pointed out in that case (p. 241):

> This Court has repeatedly rejected the contention that because a fee owned by a taxpayer was already encumbered by a lien which enjoyed seniority under state law, the Government's lien necessarily attached subject to that lien. *A fortiori*, the "property" to which the federal lien can attach is not diminished by the particular means of enforcement possessed by a competing lienor to whom federal law concedes priority.

It is clear, then, that under the provisions of Sections 3670 and 3671, the federal tax liens here involved arose and attached to all of taxpayer's property, including the real property here in issue. While this occurred *after* the real property had been mort-

gaged to Buffalo Savings Bank, it was *before* any of the state tax liens now asserted had arisen. Thus, the federal lien attached to the real estate subject only to the payment of the prior mortgage indebtedness with interest thereon. New York law could not prevent the federal lien from attaching to the real estate. Nor could the particular means of enforcement which State law afforded to a competing lienor diminish the property to which the federal lien attached. *United States* v. *Brosnan*, *supra*, 363 U.S. at 241. This is in conformity with the fundamental principle that provisions of state law which are inconsistent with federal statutes "must fall under the Supremacy Clause of the United States Constitution." *United States* v. *John Hancock Mut. Ins. Co.*, 364 U.S. 301, 305;[12] *Michigan* v. *United States*, 317 U.S. 338, 340.

2. A state may not supersede federal rules of priority and obtain prior payment of subsequently accrued local liens by deeming them "expenses of the [foreclosure] sale"

The majority of the court below relied (R. 79) upon the fact that under New York State law (Section 1087) (Appendix, *infra*, p. 35) payment of local taxes, assessments and water rates which have become "liens" upon the property, sold pursuant to a judgment rendered in a mortgage foreclosure action, "are deemed expenses of the sale within the meaning of that expression as used in any provision of this article." Accordingly,

[12] There, this Court held that the United States as a junior lienor of real estate judicially foreclosed in a proceeding to which the United States was made a party under 28 U.S.C. 2410, could redeem within one year from the date of sale pursuant to 28 U.S.C. 2410(c), despite a conflicting state statute giving the mortgagors the exclusive right to redeem within that period.

it concluded that "the proper procedure of this State" required the referee to pay the real estate taxes, assessments and water rates out of the proceeds of the sale "as expenses of the sale" (R. 83). This same argument was considered and rejected on the authority of *New Britain*, by the United States District Court for the Western District of New York,[13] and by two Appellate Divisions of the Supreme Court of the State of New York,[14] as well as by the Appellate Division in the instant case.

The majority found support for its position in the decision of the Supreme Court of Connecticut (*Brown v. General Laundry Service, Inc.*, 19 Conn. Sup. 335, 113, A. 2d 601) on the remand of the *New Britain* case. Citing that case, the majority reasoned that "expenses

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[13] *Stadelman v. Harnell Woodworking Corp.*, 172 F. Sup. p. 156.

[14] *Metropolitan Life Ins. Co. v. United States*, 9 App. Div. 2d 356, 194 N.Y.S. 2d 168 (1st Dept., 1959); *Co-operative Loan and Sav. Soc. v. McDermott*, 14 App. Div. 2d 590, 218 N.Y.S. 2d 268 (2d Dept., 1961); *First Fed. Sav. & Loan Ass'n v. Lewis*, 14 App. Div. 2d 150, 218 N.Y.S. 2d 857 (2d Dept., 1961).

[15] *Buffalo Savings Bk. v. Victory*, 13 App. Div. 2d 207, 215 N.Y.S. 2d 189 (4th Dept., 1961; R. 64-68). In accord see *Dunkirk Trust Co. v. Dunkirk Laundry Co.*, 17 Misc. 2d 298, 182 N.Y.S. 2d 381 (Chautauqua County Court); but see, *contra*, *Kronenberg v. Ellenville Nurseries & Greenhouses*, 22 Misc. 2d 247, 196 N.Y.S. 2d 106 (Sullivan County Court); *First Federal Sav. & Loan Ass'n of Port Jervis v. Levy*, 31 Misc. 2d 459, 222 N.Y.S. 2d 908 (Sullivan County Court); and *Rikoon v. Two Boro Press, Inc.*, 9 Misc. 2d 591, 171 N.Y.S. 2d 19 (S. Ct., Kings County), modified on other grounds, 8 App. Div. 2d 986, 190 N.Y.S. 2d 790 (App. Div., 2d Dept.), appeal dismissed, 9 App. Div. 2d 783, 193 N.Y.S. 2d 302 (2d Dept., 1959). See the comment on the latter case, made by the Appellate Division in its second opinion in the instant case (R. 65).

of sale have always been determined by State, rather than Federal, law * * * (R. 79–80).[16]

We do not question that the actual expenses of a mortgage foreclosure are entitled to priority of payment out of the proceeds of sale over all lien claimants. Neither do we question the right of a mortgagee, who has paid local taxes prior to the filing of the federal tax lien, to add the amount thereof to his mortgage, and have priority therefor. But local taxes are obviously not part of the expenses of foreclosing a mortgage, and a State may not, by classifying them as such, accord them priority over earlier federal tax liens. This was not what was done in the *New Britain* case, for the expenses allowed by the Connecticut court on the remand of that case did not encompass local real estate taxes. See *Brown* v. *General Laundry Service*, *supra*.

Whatever may be the priority status of the actual costs of disposing of encumbered property,[17] it is clear that a state cannot alter the federal rules of priority

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[16] The Court also attempted to support its conclusion by citing *United States* v. *Brosnan*, 363 U.S. 237, in which the Court adopted state procedures for divestiture of junior liens as federal law. We treat the majority's position that *Brosnan* requires adoption of a state's definition of expenses of sale, *infra*, pp. [redacted].

[17] The costs and expenses allowed in mortgage foreclosure proceedings by New York law are set forth at Sections 554 and 555, 49 McKinney's Consolidated Laws of New York Annotated (Part 2). See also Wiltzie, *Mortgage Foreclosure* (5th ed., 1939), Vol. 2, Sec. 929 *et seq.*, Vol. 3, Sec. 1007. The New York Court of Appeals has distinguished between expenses of "sale" which, as defined in Section 1087, includes unpaid taxes and assessments, and expenses to "foreclose." *Wesselman* v. *Engel Co.*, 309 N.Y. 27, 127 N.E. 2d 736.

of liens by merely designating a particular type of state lien—*which is totally unrelated to the actual cost of sale of encumbered property*—as an "expense" of the "sale" of the foreclosed property. To recognize any such state power to determine priorities by a mere change in terminology is to authorize the state to subordinate earlier-arising federal tax liens to any state-created lien the state chooses to call an expense of the foreclosure action. As the dissenting opinion points out (R. 84):

> [C]alling the local taxes "expenses of the sale" does not help the local taxing authority, for it is to substance, not form, that the courts look. Local taxes do not result from the mortgage foreclosure sale; on the contrary, they are pre-existent to the sale. Accordingly, the State's characterization of them as "expenses of the sale"—appropriate though it may be for the State's own purposes—is thoroughly unreal in our present context and completely ineffectual to affect the priority of the Federal lien.

Moreover, as Judge Fuld points out (R. 88–89), at the time the federal tax lien arose and attached to the mortgaged property as a choate and perfected lien, the local taxes here involved had not even come into being. They might never have become liens against the property, since they might have been paid by the mortgagor or the property might have been foreclosed before they became due. In that event, the federal tax lien could have been satisfied out of the proceeds of the sale after payment of proper expenses and of the amount

due on the mortgage plus interest to the date of payment. Thus, the liens of the local authorities had at best only a potential existence (R. 89) "It comports neither with reality nor with law to give such 'potential liens' priority over the pre-existing matured Federal lien by labeling them 'expenses of the sale' in foreclosure proceedings."

3. United States v. Brosnan, 363 U.S. 237, does not call for the application of the New York statutory provisions which treat the payment of liens for local taxes as an expense of a mortgage foreclosure sale, so as to defeat the priority of the federal lien.

In *United States* v. *Brosnan*, 363 U.S. 237, the United States contested the validity of state procedures which provided that a senior mortgagee might divest the claims of junior lienors (including the United States) without recourse to a judicial sale. The Court noted that, while federal law determines what are permissible divestiture procedures, Congress had not entered the field. Under the circumstances, it found it desirable to adopt as federal law the state law on the theory that "in this instance" the need for uniformity is outweighed by the severe dislocation to local property relationships which would result from disregarding state procedures. Accordingly, it held that the junior lien of the United States had been extinguished.

The court below found in *Brosnan* a departure from this Court's holding in *New Britain* (R. 80–81), in that the divestiture decree affirmed in *Brosnan* had provided for the payment of local taxes out of the

foreclosure sale."[*] However, this Court was not asked to consider and did not pass upon the validity or effect of the sheriff's payment of such taxes, for the only contested issue involved the propriety of the state procedures for foreclosure. See Judge Fuld's discussion of this point in his dissenting opinion (R. 89–90).

Nor does the Court's decision in *Brosnan* of the issue presented to it—whether Congress had superseded state procedures for the divestiture of junior liens—lend support to the conclusion of the majority. Sections 1082 and 1087 of the New York Civil Practice Act do not establish procedures for the divestiture of liens or for any other purpose. They deal with the order of payment of claims, a substantive matter of priorities which *Brosnan* makes clear is governed not by state law but by Section 3670 as interpreted in *New Britain*, 363 U.S. at 240–241.

The dislocation to local property relationships which concerned the Court in *Brosnan* would not result in this case from giving the federal lien the priority to which it is entitled. The fears for municipal revenues and the health of municipal bonds expressed by the majority (R. 82–83) over application of the *New Britain* rule are without merit. Indeed,

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[*] The Third Circuit's opinion (264 F. 2d at 764) merely noted without comment that the amount bid by the purchaser at the sheriff's sale "went to satisfy costs of the sale, and for various outstanding local taxes." The opinion in *Brosnan* also cites *New Britain* in support of the statement (363 U.S. at 241) that the "property" to which the federal lien can attach "is not diminished by the particular means of enforcement possessed by a competing lienor to whom federal law concedes priority."

similar arguments made by the City in the *New Britain* case, and by the mortgagee in *United States* v. *Union Central Life Ins. Co.*, 368 U.S. 291, were rejected by this Court. Under the rule of the *New Britain* case, the States do not lose the priority of their taxes over mortgages. As pointed out by Seligson, *op. cit.*, p. 285, the States do not need protection in this respect. As between the State and the mortgagee, the former is entitled to priority of payment and it receives its taxes at the expense of the mortgagee. Concededly, the interest of the mortgagee is diminished to the extent that local taxes are paid from the mortgagee's share of the proceeds of the foreclosure sale. However, as the New York Court of Appeals has stated, the purpose of Section 1087 is to protect not the mortgagee, but the purchaser at a foreclosure sale who is entitled to clear title (*Wesselman* v. *Engel Co.*, 309 N.Y. 27, 127 N.E. 2d 736). Nevertheless, as Judge Fuld points out in his dissenting opinion (R. 90), the mortgagee is not left without recourse where the mortgagor is liable for payment of the debt secured by the mortgage and is not insolvent, for "In such a case, the mortgagee may collect the 'residue' or balance due from the mortgagor by way of a deficiency judgment" (citing Sections 1082 and 1083 of the New York Civil Practice Act, Appendix, *infra*, p. 34). Furthermore as Seligson, *supra*, also points out (p. 285):

> Acceptance of the view of the majority in *Buffalo Savings* will compel the federal government to initiate proceedings for the foreclosure of its liens immediately after those liens

arise. The forced sale of property subject to government liens will certainly not be beneficial to the economy of the country. But the government will have no practical alternative. Any delay in foreclosing is bound to prejudice the government. Neither the local taxing authority nor the mortgagee need take any action to collect or compel the payment by the mortgagor of accruing real estate taxes. Whatever the delay on the part of the local taxing authority, its taxes will have priority over the federal lien whenever foreclosure occurs. If the mortgagee desires to avoid a real estate tax foreclosure sale he need only pay taxes as they accrue and add these taxes to the mortgage debt, thus maintaining his priority over the federal tax lien. *It cannot be that Congress intended this result to follow from the language used in the federal tax lien statutes.* [Emphasis added.]

4. The rules of priority established by New Britain *do not give way where state law creates a "circular priority" of liens*

Section 3672 of the Internal Revenue Code of 1939 (Appendix, *infra*, p. 33) affords the mortgage lien first priority here because the mortgage was executed and recorded in 1946 (R. 31–32), seven years prior to 1953 when the United States filed notice of its tax lien and more than 10 years before the liens for city and county real estate taxes and sewer rents attached in 1957 and 1958. New York law, however, grants the city and county liens priority over the mortgage without reference to the later dates of their attachment. This presents a problem of "circular priority" of liens.

Noting the conflict between satisfaction of the mortgagee's first priority under federal law and respect for state rules for determining the priority of non-federal liens *inter se*, the majority below held that the rule of "first in time, first in right" (*United States* v. *New Britain, supra,* at 87) does not apply in cases of circular priority (R. 77). The majority attempted to justify its holding by suggesting that *New Britain* so held or that if it did not, the ruling "is too far removed in the light of the real issue here * * *" (R. 77). This suggestion was plainly error.

It is clear beyond dispute that in *New Britain* this Court was faced with and deliberately resolved the very question of circular priority of state and federal liens that alone is in issue in this case. See 347 U.S. at 87–88. In *New Britain*, state law granted the local tax liens a priority over mortgage liens.[*] Federal law, as there determined by this Court, established the following order or priority: (1) mortgage lien; (2) federal tax liens; (3) state tax liens. Both the Connecticut Supreme Court of Errors and this Court agreed that no provision of federal law prevented the state from giving priority to various state liens (such as real estate tax and water-rent liens) over mortgages and judgments. It therefore was apparent that a mortgagee would enjoy the full benefit of its mortgage only if the federal lien were subordinated to any state lien which the state chose to make prior in right to a

[*] See the first opinion of the Connecticut Supreme Court of Errors in *New Britain*, reported *sub nom. Brown* v. *General Laundry Service, Inc.*, 139 Conn. 363, 94 A. 2d 10.

mortgage lien. This Court took careful note of this inevitable consequence but nevertheless unequivocally concluded that federal rules alone determine the priority of the federal tax lien and that these rules are unaffected by any burden of subordination the state may choose to impose upon the mortgage lien which the federal statute respects. The Court held (347 U.S. at 88) that:

> The United States is not interested in whether the State receives its taxes and water rents prior to mortgagees and judgment creditors. That is a matter of state law. But as to any funds in excess of the amount necessary to pay the mortgage and judgment creditors, Congress intended to assert the federal lien. There is nothing in the language of § 3672 to show that Congress intended antecedent federal tax liens to rank behind any but the specific categories of interests set out therein, and the legislative history lends support to this impression.

In sum, federal law was held to determine the relative priority of a federal tax lien vis-a-vis any and all state liens, regardless of inconsistent state law. State law was left free to determine the relative priorities of non-federal liens among themselves.

Actually the court below has resolved the problem of circular priorities by eliminating it; it has held that the federal tax lien is always subordinate to municipal tax liens, regardless of their respective priorities in time. On its view, even absent a senior mortgage, later-assessed and perfected local real estate tax liens can themselves be foreclosed by a sale free and clear of prior federal tax liens (R. 83). But

the foundation of the *New Britain* decision, as we have demonstrated above, is the priority of the federal tax lien over later-arising local tax liens because both are of equal dignity and to be paid in order of first in time, first in right. The decision below subverts this basic principle of federal tax lien law.

C. OTHER COURTS HAVE CONSISTENTLY REJECTED THE GROUNDS ON WHICH THE MAJORITY BELOW ATTEMPTED TO DISTINGUISH *NEW BRITAIN* AND HAVE HELD THE FEDERAL TAX LIEN ENTITLED TO PRIORITY IN CASES INDISTINGUISHABLE FROM THIS

There are no authoritative decisions which support the lower court's attempted distinctions of *New Britain*. On the contrary, the federal and state courts have repeatedly rejected such distinctions and have uniformly upheld the priority of the federal tax lien in cases indistinguishable from the instant case. *United States* v. *Bond*, 279 F. 2d 837 (C.A. 4), certiorari denied, 364 U.S. 895; *United States* v. *Christensen*, 269 F. 2d 624 (C.A. 9); *United States* v. *Wasserman*, 257 F. 2d 491 (C.A. 1); *United States* v. *Costas*, 142 So. 2d 699 (Ala. Sup. Ct.); *Union Central Life Ins. Co.* v. *Peters*, 361 Mich. 283, 105 N.W. 2d 196, reversed on other grounds, *sub nom. United States* v. *Union Central Life Ins. Co.*, 368 U.S. 291; *First Nat. Bank of Chippewa Falls* v. *Henneman Co.*, 10 Wis. 2d 260, 103 N.W. 2d 24, certiorari denied, 364 U.S. 836; and *Southern Ohio Savings Bank & Trust Co.* v. *Bolce*, 165 Ohio St. 201, 135 N.E. 2d 382. See also *American Surety Co.* v. *Sundberg*, 58 Wash. 2d 337, 363 P. 2d 99, certiorari denied, 368 U.S. 989, and

Samms v. Chicago Title & Trust Co., 349 Ill. App. 413, 111 N.E. 2d 172.[38]

In *Bond*, real estate taxes had accrued and were paid by the mortgagee subsequent to the recordation of the notice of the federal tax lien. The court rejected the mortgagee's contention that the "inchoate lien test" was not applicable in view of the fact that a federal tax lien is not valid against a mortgagee under Section 6323(a) of the 1954 Code (Section 3672(a) of the 1939 Code) until recorded. The court held (279 F. 2d at 846) that "the claimed priority for payment of the real estate taxes accruing after recordation of the federal tax liens, even though made pursuant to an authorized provision of a prior recorded mortgage, must be subordinated to the federal tax lien because such lien so acquired by the mortgagee was unperfected and inchoate at the time the federal tax liens were recorded."

Under facts identical to those in *Bond*, the Ninth Circuit in *United States* v. *Christensen*, 269 F. 2d at 624–625, held that the federal sovereign was not to be frustrated in the collection of its revenue by the tax-priority laws of half a hundred different states, and that, once a federal tax lien had been duly recorded, it became senior in right to the claims of a prior mortgagee who had paid city or state taxes subsequent to the assess-

[38] In the *Sundberg* case it was held that a mortgage which secured future advances was superior to a federal tax lien only to the extent of the advances made before the filing of notice of the federal lien; in *Samms*, it was held that a mechanics lien which, under state law, was superior to a mortgage lien was inferior to a federal tax lien which in turn was subordinate to the mortgage.

ment of the federal taxes and the filing of notices thereof. In such a case, the court added, the ancient maxim "The first in time is the first in right" has "a peculiarly salutary application."

Nor may *Bond* and *Christensen* be distinguished on the ground that the mortgagee paid the local taxes which fell due following the filing of notice of the federal tax lien. There is no difference in principle between giving subsequent local taxes priority over the federal tax lien and permitting the mortgagee to pay them and add the amount thereof to the mortgage debt. Neither is there any difference in principle or effect between designating such local taxes as "expenses of the sale" and ordering the property sold "subject to" those taxes but free and clear of the federal tax liens.[21] In either of those situations, the state is attempting to give its subsequently accruing local taxes priority over the federal tax lien. The *New Britain* case makes it clear that Congress did not intend that the federal tax lien should be subordinated to junior encumbrances having priority over mortgages and judgment liens simply because the federal lien was subordinate to such mortgages and judgment liens.

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[21] Prior to the decision of the New York Court of Appeals in the instant case, the New York Supreme Court (Nassau County) ordered a sale of mortgaged property "subject to" local taxes, thereby according those taxes priority over federal tax liens. (*Feinstein* v. *Earl*, 228 N.Y.S. 2d 643.) Subsequent to the decision in the instant case, and upon the authority thereof, the Appellate Division, 2d Department, affirmed the ruling of the Nassau County Court. Application for leave to appeal has been filed by the United States and is still pending.

CONCLUSION

The judgment of the New York Court of Appeals should be reversed and the case should be remanded with directions to award priorities in accordance with the rule of the *New Britain* case, as directed by the Appellate Division in its order and opinion of May 18, 1961 (R. 60–68).

Respectfully submitted.

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APPENDIX

Internal Revenue Code of 1939 (26 U.S.C., 1952 ed.):

SEC. 3670. PROPERTY SUBJECT TO LIEN.

If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, penalty, additional amount, or addition to such tax, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.

SEC. 3671. PERIOD OF LIEN.

Unless another date is specifically fixed by law, the lien shall arise at the time the assessment list was received by the collector and shall continue until the liability for such amount is satisfied or becomes unenforceable by reason of lapse of time.

SEC. 3672 [as amended by Sec. 401 of the Revenue Act of 1939, c. 247, 53 Stat. 862, and Sec. 505 of the Revenue Act of 1942, c. 619, 56 Stat. 798]. VALIDITY AGAINST MORTGAGEES, PLEDGEES, PURCHASERS, AND JUDGMENT CREDITORS.

(a) *Invalidity of Lien without Notice.*—Such lien shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the collector—

(1) *Under state or territorial laws.*—In the office in which the filing of such notice is authorized by the law of the State or Territory in which the property subject to the lien is situated, whenever the State or Territory has by

law authorized the filing of such notice in an office with the State or Territory; or

* * * * *

6A Gilbert-Bliss Civil Practice of New York, Annotated (recompiled 1944):

SEC. 1082. *Final judgment; surplus moneys:*

1. In an action to foreclose a mortgage upon real property, if the plaintiff becomes entitled to final judgment, it must direct the sale of the property mortgaged or of such part thereof as is sufficient to discharge the mortgage debt, the expenses of the sale and the costs of the action except as provided in subdivision two of this section. All surplus moneys arising from the sale of mortgaged premises under any judgment shall be deposited by the officer appointed to conduct the sale of the premises within five days after the same shall be received and be ascertainable to the credit of the action in a bank or trust company named by the court in the final judgment unless otherwise specially directed, subject to the further order of the court; and every judgment in foreclosure shall contain such directions, except where other provisions are made specially by the court. * * *.

SEC. 1083. *Judgment for deficiency; limitation.*

If a person who is liable to the plaintiff for the payment of the debt secured by the mortgage is made a defendant in the action, and has appeared or has been personally served with the summons, the final judgment may award payment by him of the whole residue, or so much thereof as the court may determine to be just and equitable, of the debt remaining unsatisfied, after a sale of the mortgaged property and the application of the proceeds, pursuant to the directions contained in such judgment, the amount thereof to be determined by the court as herein provided. * * *.

* * * * *

SEC. 1087. *Payment of taxes, assessments and water rates out of proceeds of sale.*

Where a judgment rendered in an action to foreclose a mortgage upon real property directs a sale of the real property, the officer making the sale must pay out of the proceeds, unless the judgment otherwise directs, all taxes, assessments and water rates which are liens upon the property sold, and redeem the property sold from any sales for unpaid taxes, assessments or water rates which have not apparently become absolute. The sums necessary to make those payments and redemptions are deemed expenses of the sale within the meaning of that expression as used in any provision of this article. * * *.

McKinney's Consolidated Laws of New York, Annotated:

New York Lien Law:

SEC. 240(1). [1962 Cum. Supp.]

Notices of liens upon real property for taxes payable to the United States of America and certificates releasing or discharging such liens shall be filed in the office of the clerk of the county in which real property subject to any such lien is situated. * * *.

New York Public Authorities Law:

SEC. 1180.

* * * The [Buffalo Sewer] authority shall hear and examine any such complaints and may modify the proposed schedule and shall adopt a final schedule of sewer rents within sixty days after the date of said notice. * * * From and after the due date thereof, such sewer rents shall constitute a lien upon the real property served by the facilities. Such lien shall have the same priority and superiority as the lien of the general tax of the city. * * *

New York Real Property Tax Law:

SEC. 902. [Historical Note]

The amount of all taxes and assessments levied by the board of supervisors under this chapter or other law, upon any parcel of real property located in the county shall, except as specifically otherwise provided, be and become a lien thereon as of the first day of January of the fiscal year for which such taxes and assessments are levied and shall remain such a lien until paid.

Erie County Tax Act:

SEC. 6-2.0, Laws of 1942, Ch. 812.

* * * After the board of supervisors shall have duly completed the tax rolls of the several cities and towns of said county, the taxes and assessments thereon shall be and become liens as of the first day of January next ensuing the levy thereof and shall remain such liens until paid * * *.

City of Buffalo Charter (1950):

SEC. 534.

All taxes and assessments, together with interest thereon as provided by law, shall be liens upon the lands upon which they are assessed from the time of publication of the notice by the board of assessors required by section five hundred ninety until paid and shall be preferred in payment to all other charges. Taxes and assessments upon the general tax rolls may be paid and shall have priority in the inverse order of time in which they become liens, and all taxes and assessments which are now liens on the property assessed shall continue to be liens until paid.

SEC. 590.

On or before June twentieth in each year the board of assessors shall publish a notice in the

publication or publications designated by the council that the payment of local assessments returned on the general tax roll and the general city tax on said roll may be made to the city treasurer at the times, and in the manner and with the additions provided in the next succeeding sections.

U.S. GOVERNMENT PRINTING OFFICE: 1982